STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission on Its Own Motion Northern Illinois Gas Company d/b/a Nicor Gas Company Reconciliation of Revenues collected under Gas Adjustment Charges with Actual Costs Prudently Incurred	)	Docket No. 01-0705
Illinois Commerce Commission on Its Own Motion Northern Illinois Gas Company d/b/a Nicor Gas Company Proceeding to Review Rider 4, Gas Cost Performance Program, pursuant to Section 9-244(c) of the Public Utilities Act	)	Docket No. 02-0067
Illinois Commerce Commission on Its Own Motion Northern Illinois Gas Company d/b/a Nicor Gas Company Reconciliation of Revenues Collected under Gas Adjustment Charges with Actual Costs Prudently Incurred	)	Docket No. 02-0725

Surrebuttal Testimony on Reopening of

PAUL R. CARPENTER

Principal
The Brattle Group

On Behalf of
Northern Illinois Gas Company
d/b/a Nicor Gas Company

December 20, 2011

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I. INTRODUCTION AND SUMMARY OF CONCLUSIONS

Q. Please state your name, address and current position.

A. My name is Paul R. Carpenter. I am a Principal of The Brattle Group, an economic and management consulting firm. My office is located at 44 Brattle Street, Cambridge, Massachusetts 02138.

Q. Have you previously testified in this proceeding?

A. Yes. I submitted prepared rebuttal testimony on behalf of Northern Illinois Gas Company d/b/a Nicor Gas Company ("Nicor Gas" or the "Company") in this proceeding on April 29, 2011.

Q. What is the purpose of this surrebuttal testimony?

A. My surrebuttal testimony responds to the rebuttal testimony concerning damages submitted by David J. Effron (on behalf of the Illinois Attorney General ("AG"), Jerome D. Mierzwa (on behalf of the Citizens Utility Board ("CUB"), and Richard J. Zuraski (of the Staff ("Staff") of the Illinois Commerce Commission ("Commission").

Q. Will you summarize your response to Staff and Intervenor witnesses pertaining to each of the individual categories of damages?

A. Yes. I respond as follows:

1) The damages proposals of Mr. Effron and Mr. Mierzwa related to Nicor Gas' 2001 storage withdrawals should be rejected. Their proposals are based on the kind of hindsight review that is inappropriate for a prudence evaluation in that they fail to assess the reasonableness of Nicor Gas' decisions based on information available at the time those decisions were made. Neither of these

witnesses offer any response whatsoever to my rebuttal testimony's description of the unexpected and unprecedented nature of the price spike that occurred in U.S. gas markets in 2000-2001. (*See* Carpenter Reb., Nicor Gas Ex. 5.0, 15:296-17:318). These market conditions are critical to understanding Nicor Gas' storage activity in November and December 2000. Mr. Effron's attempt to link Nicor Gas' low storage inventory at the end of 2000 to its LIFO liquidation strategy is not supported by the evidence. (Effron Reb., AG Ex. 1.4, 8:163-68). He fails to consider that Nicor Gas' storage inventory at the end of October 2000 was in line with prior year inventory levels, and he fails to consider the November and December 2000 withdrawals in light of the price spikes that occurred. Both Mr. Effron and Mr. Mierzwa fail to acknowledge that Nicor Gas' storage withdrawals in November and December 2000 lowered costs for its customers, just as the GCPP intended, and that Nicor Gas' low storage inventory level at the end of 2000 was consistent with what was happening to gas storage inventories across the U.S. Mr. Mierzwa's claim that Nicor Gas could have withdrawn more in January 2001 (based on Nicor Gas' January 2003 withdrawal experience) is more hindsight speculation based on a single month of data. (Mierzwa Reb., CUB Ex. 2.0, 41:911-42:927). If Mr. Mierzwa had chosen to examine a slightly longer period of time (January through April 2003) he would have discovered that his damage proposal for 2001 includes much higher withdrawal levels than actually occurred in 2003. This discrepancy further illustrates the danger associated with the twenty-twenty hindsight that Mr. Mierzwa is applying in this proceeding.

2) The damage proposals of Intervenors and Staff related to liquidation of low cost LIFO layers should be rejected. As discussed in my rebuttal testimony (Nicor Gas Ex. 5.0, 23:427-27:522), these claims are not based on any economic rationale, and the way they are now being justified by these witnesses they appear to me to be simply punitive in nature.

3) The damage proposals offered by Mr. Zuraski and Mr. Mierzwa related to in-field transfers should be rejected because they have not offered any economic rationale as to why in-field transfers should be included when quantifying withdrawals under the Gas Cost Performance Program ("GCPP"). (Zuraski Reb., Staff Ex. 5.0, 11:198-12:229; Mierzwa Reb., CUB Ex. 2.0, 9:185-12:273). There *is* an economic rationale for excluding in-field transfers that neither witness disputes: in-field transfers are only undertaken for operational reasons. They are not withdrawals made for the purpose of serving customers. Neither Mr. Zuraski nor Mr. Mierzwa disagrees with my re-calculation of the Commodity Adjustment in Docket No. 99-0127 after excluding in-field transfers from the calculation. As I explained, the change to the Commodity Adjustment by excluding in-field transfers (which was Mr. Mierzwa's and Mr. Zuraski's original rationale for excluding them) would have been negligible. (Carpenter Reb., Nicor Gas Ex. 5.0, 33:637-34:641).

4) Mr. Mierzwa's and Mr. Zuraski's damage claims related to additional DSS storage withdrawals should be rejected. (Zuraski Reb., Staff Ex. 5.0, 13:230-14:255; Mierzwa Reb., CUB Ex. 2.0, 12:275-17:374). Mr. Zuraski has not explained the basis for his adjustment in his testimony. Mr. Mierzwa bases his

claim on a document he believes shows Nicor Gas' physical DSS withdrawals to be greater than those used in Nicor Gas' restatement. (Mierzwa Reb., CUB Ex. 2.0, 14:325-15:336). However, my review of Nicor Gas' restated storage reports suggests that the document relied upon by Mr. Mierzwa does not, in fact, reflect Nicor Gas' physical DSS storage withdrawals.

5) Mr. Mierzwa's and Mr. Zuraski's damage claims related to Nicor Gas' sales of gas to its affiliate and its discounted sale of gas related to its purchase of weather insurance should be rejected. (Zuraski Reb., Staff Ex. 5.0, 14:256-19:364; Mierzwa Reb., CUB Ex. 2.0, 17:376-22:488). These claims are based on hindsight, and are now shown to be similarly punitive in nature. As I stated in my rebuttal testimony, any damage claim relating to these two categories of damages should be limited to the size of the discounts that were provided. (Carpenter Reb., Nicor Gas Ex. 5.0, 10:194-11:224, 42:823-26). If one accepts as correct the size of the discount assumed by Mr. Zuraski, I show below that the damages associated with these transactions are minimal.

6) Mr. Zuraski's proposal related to the accounting treatment of hub service revenues should be rejected. (Mierzwa Reb., CUB Ex. 2.0, 19:365-21:435). His proposal is to treat certain hub transactions ("multi-cycle loan transactions") as off-system transactions (which are credited against PGA gas costs) even though other shorter-term hub transactions are treated as utility income (and are not credited against PGA gas costs). However, despite the distinctions he is trying to draw between these types of hub transactions, in all cases Nicor Gas is still

loaning gas to third-parties, which suggests that the transactions perform the same economic function and should be accorded the same ratemaking treatment.

II. 2001 STORAGE WITHDRAWALS

Q. Will you summarize the 2001 storage withdrawal issue raised by Mr. Mierzwa and Mr. Effron? (Mierzwa Reb., CUB Ex. 2.0, 27:621-45:1007; Effron Reb., AG Ex. 1.4, 1:18-18:371).

A. Yes. Mr. Mierzwa and Mr. Effron claim that Nicor Gas withdrew too little gas from storage during 2001 and seek significant damages based on the hindsight view that Nicor Gas' storage withdrawals should have been much higher in 2001. Mr. Mierzwa recommends damages of $155.3 million and Mr. Effron recommends damages of $144.8 to $181.9 million. (*See*, *e.g.*, Mierzwa Reb., CUB Ex. 2.01; Effron Dir., AG Ex. 1.3, Sch. DJE-7). It is notable that Staff witness Zuraski does not propose any similar damage claim related to Nicor Gas' 2001 storage withdrawals.

In my rebuttal testimony, I recommended that Mr. Mierzwa's and Mr. Effron's claims related to 2001 storage withdrawals be rejected because they were based on hindsight speculation and failed to account for the reliability implications of Nicor Gas' low storage inventory following the substantial withdrawals Nicor Gas made in November and December of 2000 in response to highly unusual market conditions at the time – market conditions that no one could have foreseen when the GCPP was designed and approved. (Carpenter Reb., Nicor Gas Ex. 5.0, 8:139-52).

Q. Does the rebuttal testimony of Mr. Mierzwa and Mr. Effron cause you to change your recommendation that their claims related to 2001 storage withdrawals should be rejected?

A. No. Their testimony continues to be based on a hindsight review of Nicor Gas' actions without any regard to the reasonableness of their storage withdrawal activities based on market conditions and other information that was known at the time. As I discussed in my rebuttal testimony, Nicor Gas ended 2000 with an unusually low storage inventory which impacted its ability to withdraw gas at the start of 2001. (Carpenter Reb., Nicor Gas Ex. 5.0, 20:396-21:406).

Q. Mr. Effron criticizes your discussion of Nicor Gas' low storage inventory position at the end of 2000 and finds that the colder than normal weather in November and December 2000 does not explain the low storage inventory. (Effron Reb., AG Ex. 1.4, 6:111-8:159). How do you respond?

A. Mr. Effron focuses on only part of my testimony. Neither he nor Mr. Mierzwa offer any response whatsoever to the unexpected and unprecedented nature of the price spike that occurred in U.S. gas markets beginning in November 2000. Clearly, these circumstances are a critical part of why Nicor Gas' withdrawals in November and December 2000 were larger than in any other year between 1994 and 2000. Their attempts to overlook an unprecedented price spike and unprecedented gas price volatility, and Nicor Gas' reaction to that spike and volatility based on information available at the time decisions were made, is a fundamental flaw in their review of Nicor Gas' activities under the GCPP.

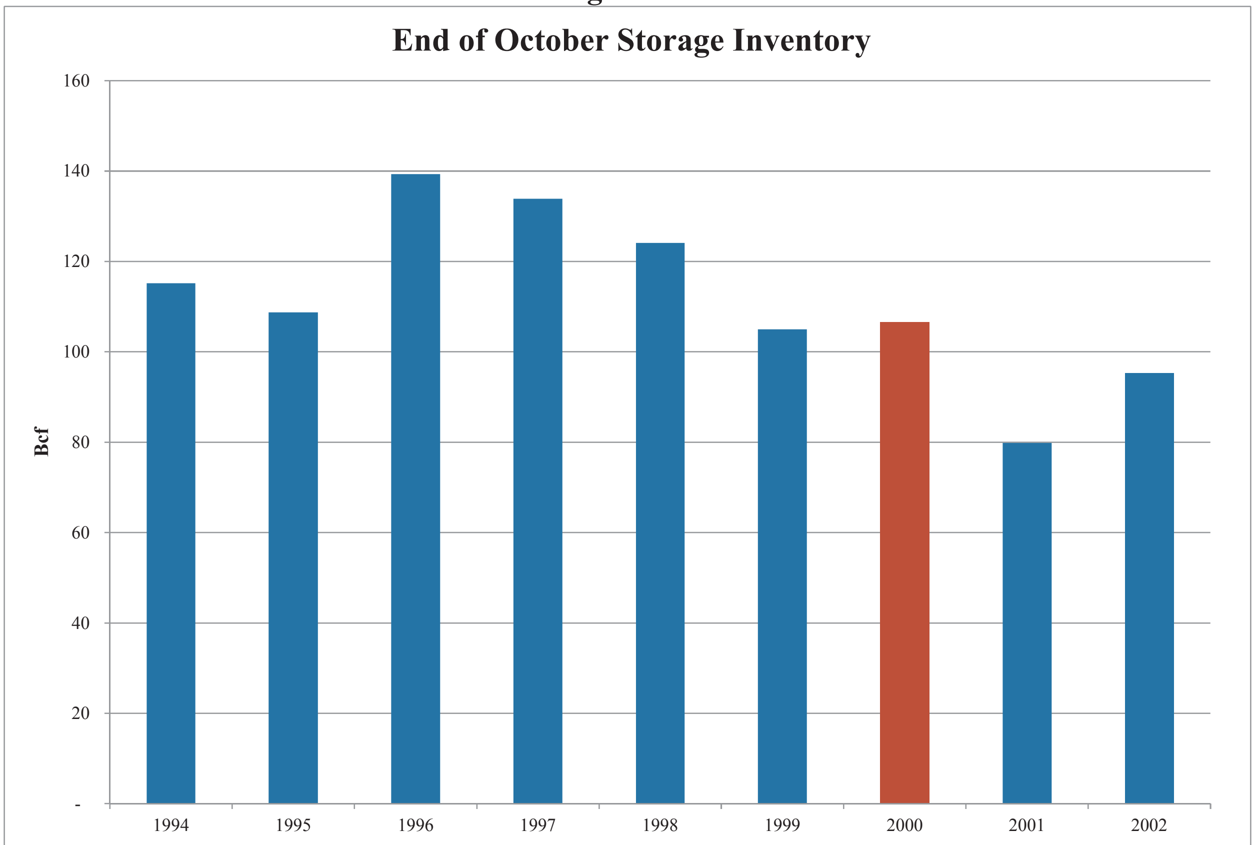
Q. What is Mr. Effron's view of Nicor Gas' low storage inventory at the end of 2000?

A. Mr. Effron believes that Nicor Gas' low storage inventory at the end of 2000 was a result of its strategy to capture a share of the benefit of low-priced LIFO gas in inventory for shareholders. (Effron Reb., AG Ex. 1.4, 8:163-66). He says that the Company "has still not presented any other plausible explanation for the low storage inventory going into the first quarter of 2001." (*Id*. at 8:166-68).

Q. How do you respond to Mr. Effron on this point?

A. Mr. Effron's attempt to link the low storage inventory at the end of 2000 to its strategy to access low-cost LIFO layers (*id*. at 8:163-68) is not supported by the evidence and it ignores other, more important factors—especially the unprecedented gas price spike and unusually cold weather in November and December 2000. Significantly, if one goes back just a few months in time, Nicor Gas had 107 Bcf of gas in storage at the end of October 2000, which was similar to other years such as 1995 (109 Bcf) and 1999 (105 Bcf), as shown below in Figure 1. Thus, there is no support for the assertion that Nicor Gas started the winter withdrawal season with an unreasonably low level of gas in storage that would have been indicative of a strategy to position itself to access low-cost LIFO layers.

Figure 1



Sources: NIC 114133-114140 and Gilmore Surrebutal Testimony in Docket No. 99-0127, Exhibit LMG-5.

Q. Do you have any other comments regarding Mr. Effron's claim that the low storage inventory at the end of 2000 was a result of the Company's strategy to capture low-cost LIFO storage inventory? (Effron Reb., AG Ex. 1.4, 8:163-66).

A. Mr. Effron's claim is not only unsupported, it is contradicted by other witnesses. In particular, Mr. Zuraski explains how Nicor Gas' strategy was to access low-cost LIFO inventory by using "pre-fill" storage deals. (Zuraski Dir., Staff Ex. 1.0R, 12:235-45). As explained by Mr. Zuraski, "pre-fill deals allowed Nicor Gas to maintain normal physical storage operations while still showing extraordinary net withdrawals, due to the manner in which the Company accounted for the deals." (*Id*. at 12:242-44). Mr. Zuraski later explains that the LIFO strategy was "an accounting trick to take advantage of historical differences in market prices, and not an actual change in the physical operation of storage." (*Id*. at 21:407-09). Mr. Zuraski's explanation is consistent with the findings of the Lassar Report, which noted that prefills "ensured that Nicor Gas could fill its storage fields – an operational necessity" and "ensured that Nicor Gas did not create a new high-cost LIFO layer through the process of refilling its storage fields." (*See* Nicor Gas Ex. 12.1 at 59). The Lassar Report also noted:

> Storage prefills were the foundation of Nicor's PBR strategy, and changing the accounting treatment of these prefills has a dramatic effect on Nicor's performance under the PBR. In effect, without the benefit of Nicor's assumed accounting treatment of prefill transactions, Nicor cannot access the low-cost LIFO layers it recognized on its financial statements.

(Nicor Gas Ex. 12.1 at 63).

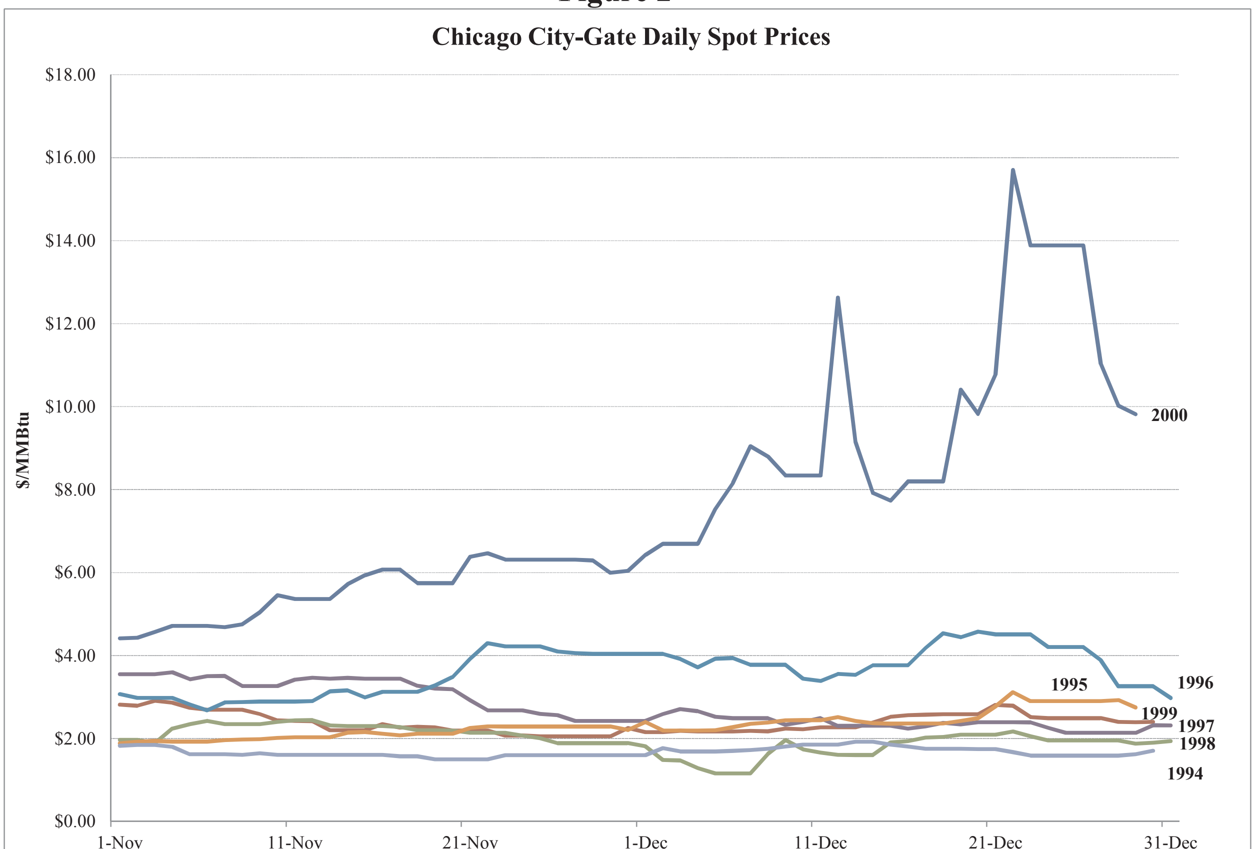
The Company's restatement, which changed the accounting treatment of the prefills and made other adjustments, eliminated the $12.2 million in shareholder savings Nicor Gas originally recognized under the GCPP for 2000 (and changed it to a $3.2 million loss). (AG Ex. 1.3.2). Thus, Mr. Effron's assertion that Nicor Gas' *physical* storage activity in 2000 was linked to its strategy to access low-cost LIFO inventory is not consistent with its actual strategy to access those layers through the accounting treatment of storage prefills.

Q. Will you explain in more detail the unprecedented price spikes that occurred during the start of the winter withdrawal season?

A. Yes. In November 2000, spot prices for natural gas in the Chicago area started to increase in a manner that was not experienced in any of the historical years on which the GCPP structure was based. The anomalous price increases in November and December

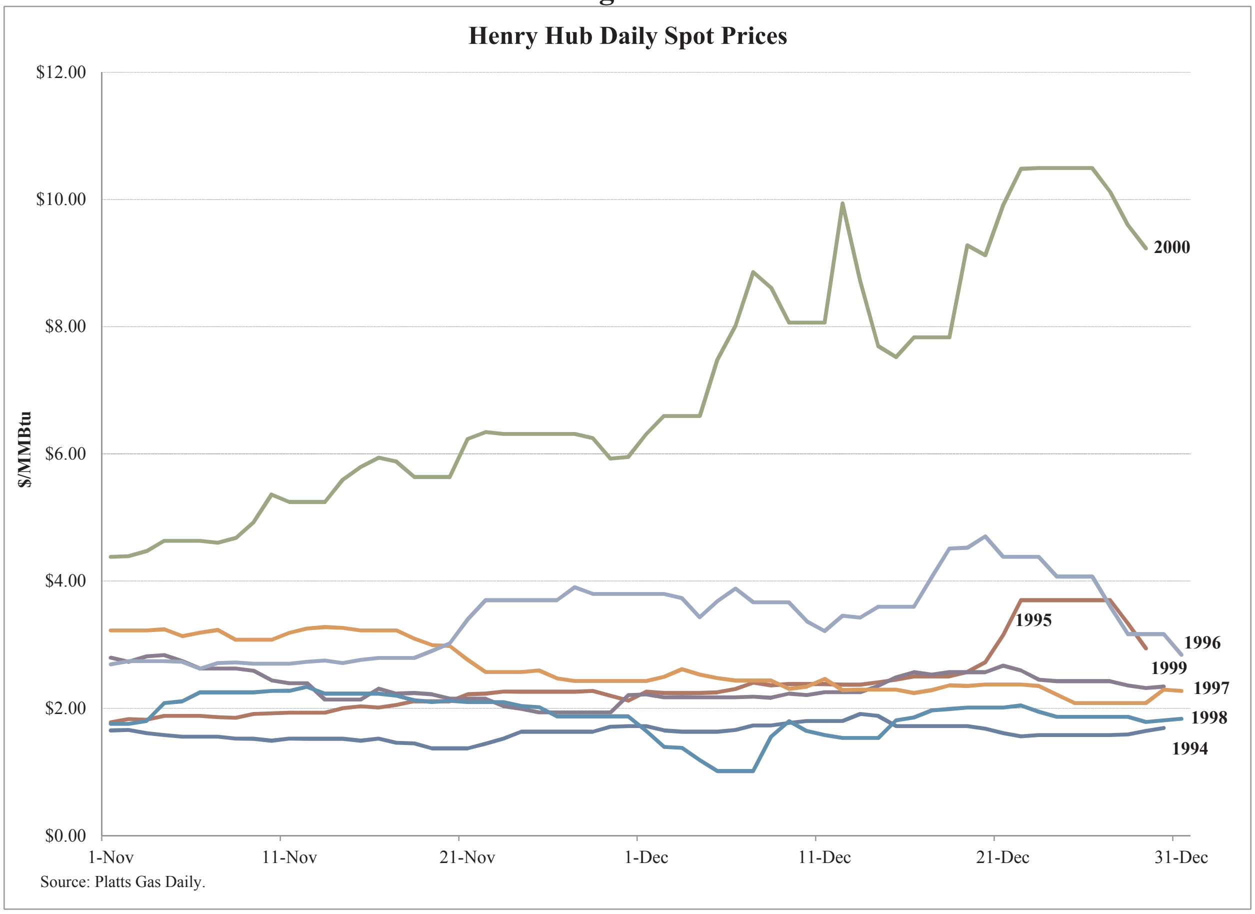
2000 can be seen below in Figures 2 and 3 in which I compare these price increases with the price patterns experienced in November and December for each of the years 1994-1999. Clearly, the GCPP was not designed or "stress tested" under the price and volatility conditions that prevailed in 2000-2001. Rather, the GCPP was conceived under much less volatile market conditions.

Figure 2



Source: Platts Gas Daily.
Note: 1994 & 1995 represent contract average prices while other years represent contract midpoint prices.

Figure 3



Q. Were Nicor Gas' withdrawals from storage in response to these unprecedented price increases unreasonable?

A. No. As I explained in my rebuttal testimony, Nicor Gas withdrew gas at high levels in November and December. These high storage withdrawals resulted in lower costs for Nicor Gas' customers. (Carpenter Reb., Nicor Gas Ex. 5.0, 8:141-48). While Mr. Effron speculates in hindsight that Nicor Gas could have further lowered costs by increasing withdrawals and reducing its purchases of flowing supplies in the early months of 2001 (Effron Reb., AG Ex. 1.4, 4:77-79), it is a fact that Nicor Gas' November and December 2000 withdrawals already lowered costs for customers. The average bid week price of gas in Chicago between May and October 2000 (the storage injection period) was

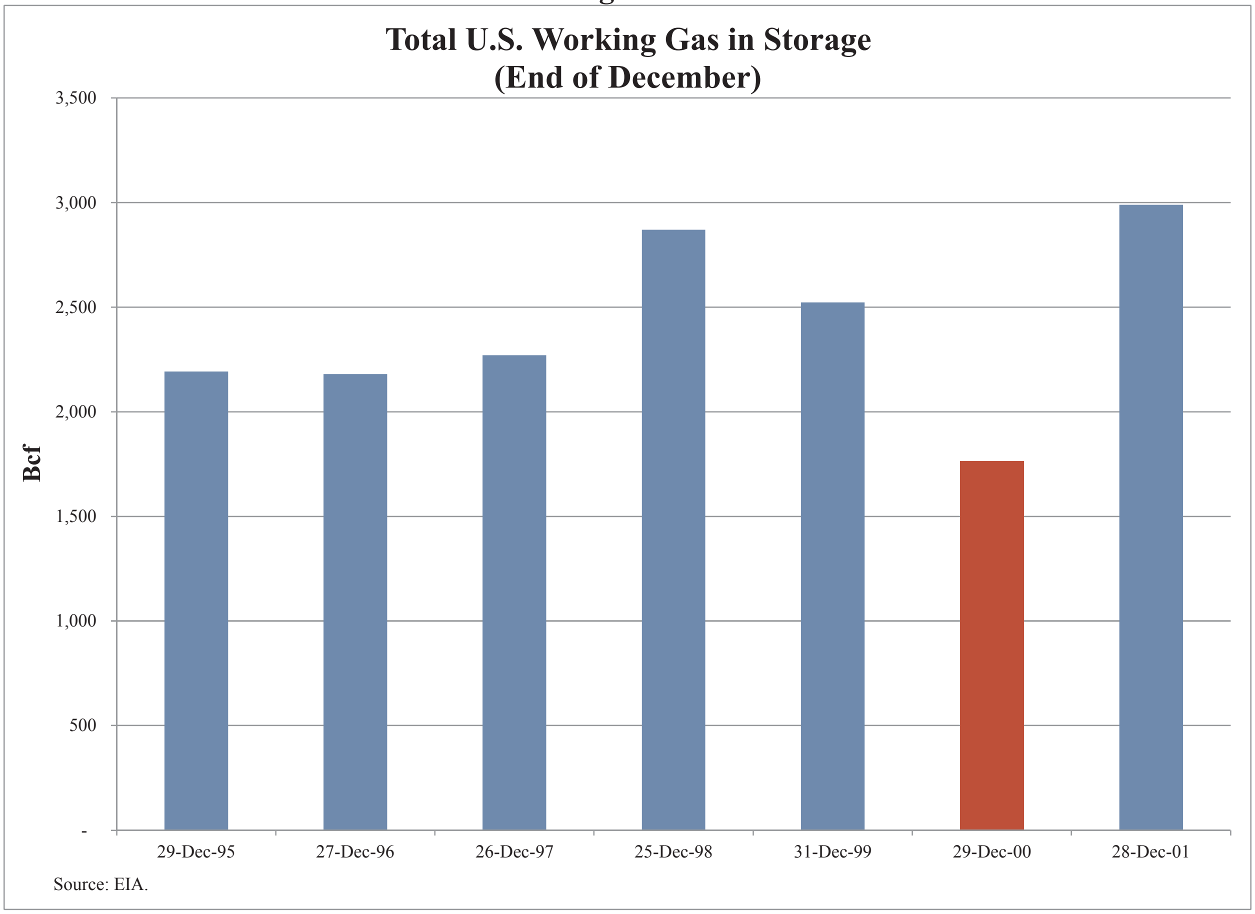
$4.33/MMBtu—compared to bid week prices of $4.60/MMBtu in November of 2000 and $6.15/MMBtu in December of 2000 during the winter withdrawal period (and even higher daily prices in November and December of 2000, as shown in Figure 2). Thus, for example, an additional MMBtu of gas withdrawn by Nicor Gas in December would have saved customers on average $1.82/MMBtu (and as much as $11.37/MMBtu on a daily basis) relative to what it paid on average to inject that gas during the summer injection season. Mr. Effron and Mr. Mierzwa both ignore the lower costs that Nicor Gas achieved for its customers in 2000 by virtue of its storage activities. Neither witness offers any evidence (using contemporaneous information) that Nicor Gas' end of October 2000 storage inventory was unreasonable, nor that its November and December 2000 withdrawals were unreasonable.

Q. Mr. Effron says the purpose of his 2001 storage calculation was "to show what the withdrawals could have been in 2001 if the withdrawals had not been constrained by the low inventory at the end of 2000" and that adjusting his calculations to take account of the low inventory at the end of 2000 would have defeated the very purpose of those calculations. (Effron Reb., AG Ex. 1.4, 9:176-81). How do you respond?

A. Mr. Effron essentially admits that he is speculating about these matters in hindsight. In fact, he candidly admits that he is not claiming the Company "necessarily would have, or even could have, implemented the increased level of 2001 withdrawals" reflected in his damage proposal. (*Id*. at 8:174-9:176). Given this, and given his complete failure to show that Nicor Gas acted unreasonably in 2000 based on information available at the time (which resulted in low storage inventory at the end of 2000), Mr. Effron's analysis is completely improper for the purpose of judging whether a gas utility's purchase and storage decisions were prudent.

Mr. Effron's observation that costs would have been lower if more gas had been stored and withdrawn (*id*. at 4:77-79) is true not only for Nicor Gas, but for gas consumers nationwide. As I discussed in my rebuttal testimony, the November and December price spikes, in part due to unusually cold weather, led to a rapid drawdown of storage inventory nationwide. (Carpenter Reb., Nicor Gas Ex. 5.0, 18:335-19:386). At the end of December 2000, U.S. gas storage inventories were much lower than normal, as shown below in Figure 4. Therefore, Nicor Gas was in a position that was comparable to the position of gas consumers nationwide. In hindsight it is clear that U.S. gas consumers nationwide, not just Nicor Gas customers, would have been better off if storage inventories had been higher at the end of 2000—but that is just hindsight. Mr. Effron ignores the price spikes that occurred in this period, and he offers no evidence that Nicor Gas' actions were unreasonable at the time they were taken. And the fact that Nicor Gas' actions mirrored nationwide trends suggests both that Nicor Gas acted properly and that the incentives in its GCPP were not out of line with the incentives faced by users of gas storage services across the U.S.

Figure 4



Q. Does Mr. Mierzwa recognize the pattern of rising prices that occurred in November and December of 2000?

A. Yes. He shows the daily prices in his Table 2-R. (Mierzwa Reb., CUB Ex. 2.0, 35:779). Mr. Mierzwa states that as a result of the increasing daily prices in November, Nicor Gas had an incentive to buy less daily gas (and increase storage withdrawals). (*Id*. at 34:774-36:796). Mr. Mierzwa, however, characterizes Nicor Gas' efforts to reduce its daily purchases in November 2000 as simply an effort to gain a benefit under the GCPP by "manipulating its storage withdrawal activity." (*Id*. at 36:800-03).

Q. How do you respond to this characterization by Mr. Mierzwa?

A. Mr. Mierzwa's characterization of this activity as a manipulation is simply an attempt to sensationalize actions that were reasonable under the market conditions at the time. Given the way the GCPP was designed, all withdrawal activity impacts the benchmark, but this does not mean the activity was "manipulative." In fact, there is no question that Nicor Gas' decision to rely less on daily flowing supply purchases and more on storage withdrawals reduced actual gas costs under the GCPP – precisely the incentives that the GCPP was designed to create. This activity was beneficial for Nicor Gas' customers. Moreover, if this were truly a "manipulation," Mr. Mierzwa offers no explanation as to why Nicor Gas did not withdraw more than it did. If this activity was intended to allow Nicor Gas to "gain a benefit," it is not clear why Nicor Gas did not purchase even less gas than it did, and withdraw more. Of course, the answer is that Nicor Gas is limited to the degree to which it can rely on storage and maintain its winter reliability obligations, a fact that neither Mr. Mierzwa nor Mr. Effron takes into account.

Q. What does Mr. Mierzwa say about Nicor Gas' December 2000 storage activity?

A. Mr. Mierzwa says that despite cold weather and a further run-up in daily gas prices, Nicor Gas did not reduce its daily gas purchases and increase its storage withdrawals (as it did in November). (Mierzwa Reb., CUB Ex. 2.0, 37:830-31). It is not clear what Mr. Mierzwa concludes about November and December of 2000. He does not seem to be claiming that the combined November and December withdrawals were excessive. He simply renders another hindsight-driven conclusion, that had Nicor Gas withdrawn 11.2

Bcf less in November and 11.2 Bcf more in December, it would have produced even lower costs for Nicor Gas' customers.[1] (*Id*. at 38:849-54; *see also* CUB Ex. 2.10).

Q. Does Mr. Mierzwa also attempt to link Nicor Gas' storage position at the end of 2000 to a strategy to capture low-cost LIFO storage inventory?

A. Yes. Mr. Mierzwa claims that Nicor Gas reduced NGPL storage injections in 2000 to access low-cost LIFO layers. (Mierzwa Reb., CUB Ex. 2.0, 38:856-40:891). However, as discussed earlier, Mr. Mierzwa's claim is contradicted by Nicor Gas' use of pre-fill accounting. That is, Nicor Gas did not have to reduce its NGPL storage injections to access low-cost LIFO layers—it could access these layers by using prefill accounting. Nonetheless, to support his claim, Mr. Mierzwa points to his Table 3-R, which shows that Nicor Gas' NGPL contract storage inventory was 14.3 Bcf at the end of October (compared to a historical average of 31.8 Bcf) and 5.9 Bcf at the end of December (compared to a historical average of 26.1 Bcf). Thus, he suggests that Nicor Gas should have had more gas in its NGPL contract storage (both at the end of October 2000 and the end of December 2000). Of course, for this to be true, Nicor Gas would have had to purchase and inject at least 17.5 Bcf more gas in 2000 (so that it had more gas in inventory by the end of October 2000 and end of December 2000)—but Mr. Mierzwa does not offer any adjustment to account for the higher gas costs that would have resulted from these increased purchase levels as an offset to his $155 million damage claim. Again, Mr. Mierzwa's arguments are plagued by contradiction and hindsight. Here he appears to argue that Nicor Gas should not have accessed low-cost LIFO inventory (*id*. at

[1] Specifically, Mr. Mierzwa calculates that had Nicor Gas reduced storage withdrawals by 11.2 Bcf in November 2000 and increased storage withdrawals by 11.2 Bcf in December 2000, it would have lowered costs by $43.4 million. (Mierzwa Reb., CUB Ex. 2.0, 38:849-54; *see also* CUB Ex. 2.10).

38:856-40:891), but in other parts of his testimony he indicates that accessing LIFO inventory for ratepayers might have been appropriate (*id*. at 26:581-87) (as discussed below).

Q. Mr. Mierzwa questions your claim that Nicor Gas was limited in how much it could withdraw in January 2001 by referencing Nicor Gas' January 2003 withdrawals (which were higher even though inventory levels were lower). (Mierzwa Reb., CUB Ex. 2.0, 41:906-42:927). How do you respond?

A. This example highlights the dangers of hindsight use of isolated historical data to support an argument about what "should have been done." I do not know (and Mr. Mierzwa does not present or analyze) the specific circumstances in January 2003 that resulted in higher storage withdrawals than 2001. However, the 2003 storage information, when viewed in its totality, shows how extreme Mr. Mierzwa's calculation for 2001 is. While total net withdrawals in January through April 2001 and 2003 were 30.3 Bcf and 35.9 Bcf, respectively, Mr. Mierzwa's 2001 damage calculation of $155 million in CUB Exhibit 1.18 assumes withdrawals should have been *73.8 Bcf* in January through April 2001—*more than double* the withdrawals in his reference year of 2003 (see Figure 5 below). Moreover, had Mr. Mierzwa's calculation of damages related to Nicor Gas' 2001 storage activities assumed the entire 2003 injection and withdrawal profile, his estimated damages would have been only $17 million instead of $155 million (*see* Nicor Gas Ex. 10.1).

Figure 5

Date	2001	2003	Mr. Mierzwa's "but-for world" Exh. No. CUB 1.18
[1]	[2]	[3]	[4]
January	17.62	23.69	31.74
February	8.28	13.45	20.97
March	3.75	7.03	14.77
April	0.68	(8.26)	6.37
Total for 4 Months	30.3	35.9	73.8

Nicor Net Withdrawals (Bcf)

Sources:
[2]: NIC 114139 Confidential
[3]: NIC 362521

III. LIQUIDATION OF LOW-COST LIFO LAYERS

Q. Will you summarize the low-cost LIFO liquidation issue raised by Staff witness Zuraski, and Intervenor witnesses Mierzwa and Effron?

A. Yes. All of these witnesses propose damages relating to Nicor Gas' liquidation of low-cost LIFO layers. As I discussed in my rebuttal testimony, the effect of their damage proposals is to impose a retroactive change to the sharing percentages that were established under the GCPP such that ratepayers will obtain 100% of the benefits of the LIFO liquidation (rather than the 50%/50% sharing approved by the Commission). (Carpenter Reb., Nicor Gas Ex. 5.0, 23:438-42).

Q. Do the Staff and Intervenor witnesses justify their claims based on any economic reasoning?

A. No. Their damage claims are not based on any economic rationale. They appear to be simply punitive. In particular, the witnesses' damages proposals appear to be based primarily on their claims that Nicor Gas hid from the Commission its strategy to access LIFO layers during the course of the proceeding that established the GCPP. Mr. Zuraski candidly admits that his damage claim would typically be inconsistent with proper regulation, but appears to believe it is justified in this case because he believes Nicor Gas was not open and honest with the Commission. (Zuraski Reb., Staff Ex. 5.0, 11:182-97).

Q. Do any of the witnesses make a showing that accessing the LIFO layers was inherently unreasonable?

A. No. In fact, Mr. Mierzwa says that had Nicor Gas been more forthcoming about its strategies, an informed decision whether to access the low-cost inventory could have been made, and that if it were found to be appropriate the parties could have explored options to liquidate the inventory under traditional regulation. (Mierzwa Reb., CUB Ex. 2.0, 26:581-87). Given this view, I think it is clear that even Mr. Mierzwa concedes what I believe, that nothing was inherently inappropriate about ultimately accessing this low-cost gas.

Q. Does Mr. Mierzwa respond to your criticism that his claims for damages for the LIFO liquidation and increased storage carrying charges are duplicative?

A. Mr. Mierzwa's rebuttal agrees that these claims are duplicative, and says that without the duplicative claims, the Commission would be rewarding Nicor Gas for its improper behavior and setting a bad regulatory precedent. (Mierzwa Reb., CUB Ex. 2.0, 27:612-14). Again, Mr. Mierzwa seems to be imposing a punitive measure of damages.

IV. IN-FIELD TRANSFERS

Q. Will you summarize the in-field transfer issue?

A. Yes. In-field transfers occur when there is a withdrawal from one storage field and a simultaneous injection at another storage field. Mr. Zuraski and Mr. Mierzwa both claim that these in-field transfers should be included when quantifying the amount of storage withdrawals in any given year. (Zuraski Reb., Staff Ex. 5.0, 12:206-13:229; Mierzwa Reb., CUB Ex. 2.0, 9:207-12:273). Their proposal increases withdrawals in any given year and thus increases the Storage Credit Adjustment ("SCA") and lowers the benchmark (assuming a positive storage credit rate). Conversely, Nicor Gas proposes to exclude withdrawals related to in-field transfers when calculating the SCA and the benchmark.

Q. What is your position on the issue of in-field transfers as it pertains to calculating the SCA?

A. As discussed in my rebuttal testimony (Nicor Gas Ex. 5.0, 34:642-48), there is an economic justification for subtracting in-field transfers from withdrawals in calculating the SCA, which is that doing so results in a measure of the *net withdrawals* that are actually made each day to serve ratepayers (as distinct from the withdrawals that are made for operational purposes). The purpose of the SCA was to reflect the value to customers of the storage capacity Nicor Gas held for its customers. Excluding in-field transfers from withdrawals for the purposes of calculating the SCA serves this purpose.

Q. Did Staff and Intervenor witnesses provide any economic justification as to why in-field transfers should be included in the calculation of the SCA in their direct testimonies?

A. No. As discussed in more detail in my rebuttal testimony (Nicor Gas Ex. 5.0, 31:582-32:602), their proposal to classify in-field transfers as withdrawals for the purposes of calculating the SCA was not supported by any economic rationale but rather by their procedural observation that Nicor Gas did not raise the issue of the appropriate treatment of in-field transfers in Docket No. 99-0127 and their claim that the Commodity Adjustment calculated in that proceeding would have been lower had Nicor Gas subtracted in-field transfers from total withdrawals. In my opinion, this position simply raises form over substance.

Q. In your rebuttal testimony did you demonstrate that the Commodity Adjustment remains virtually unchanged when in-field transfers are taken into account?

A. Yes. I recalculated the Commodity Adjustment using the same methodology and data that were relied upon to calculate the Commodity Adjustment in Docket No. 99-0127 (Nicor Gas Ex. 5.2). This recalculation showed that excluding in-field transfers would have reduced the Commodity Adjustment by merely $0.0005 per MMBtu, from its approved level of $0.0168 per MMBtu to $0.0163 per MMBtu.

Q. Do Staff and Intervenor witnesses admit that the Commodity Adjustment remains virtually unchanged due to the exclusion of in-field transfers?

A. Yes. Staff witness Zuraski admits that the exclusion of in-field transfers would result in a "small change," which in a three year period would have reduced the benchmark by only

$385,165. (Zuraski Reb., Staff Ex. 5.0, 12:219-22). Similarly, CUB witness Mierzwa does not disagree with my recalculation of the Commodity Adjustment in Nicor Gas Ex. 5.2. (Mierzwa Reb., CUB Ex. 2.0, 11:249-52).

Q. What is their overall position regarding the issue of in-field transfers in their rebuttal testimonies?

A. Both Mr. Zuraski and Mr. Mierzwa continue to argue that withdrawals related to in-field transfers should be included in the calculation of the SCA because they were included in the calculations performed in Docket No. 99-0127. (Zuraski Reb., Staff Ex. 5.0, 12:206-13; Mierzwa Reb., CUB Ex. 2.0, 11:254-56). They still do not offer an economic justification for their proposal. The only economic effect that would have resulted in Docket No. 99-0127 from excluding withdrawals related to in-field transfers as Nicor Gas now proposes, and I agree is justified, is that the Commodity Adjustment component of the benchmark would have been reduced by a trivial amount. In my view, there is an economic justification for subtracting in-field transfers (as I explained above). For this reason, I believe the Commission should reject their proposal to include in-field transfers in the calculation of withdrawals and their corresponding damage claims.

V. ADDITIONAL DSS WITHDRAWALS

Q. Will you summarize the issue regarding additional DSS storage withdrawals?

A. Yes. Mr. Mierzwa and Mr. Zuraski both claim that Nicor Gas has incorrectly quantified storage withdrawals in each year by excluding some storage withdrawals under a storage contract Nicor Gas had with NGPL (*i.e.*, a purchased storage service under NGPL's rate schedule DSS, or Delivered Firm Storage Service). (Mierzwa Reb., CUB Ex. 2.0, 12:278-14:308; Zuraski Reb., Staff Ex. 5.0, 13:230-14:255). However, as I explained in my rebuttal testimony, Nicor Gas already restated its GCPP results to correct for its prior treatment of DSS storage capacity. (Carpenter Reb., Nicor Gas Ex. 5.0, 35:671-72). I also explained that neither witness offered an explanation, or any evidence, of how the prior restatements were deficient. (*Id*. at 35:678-79). Instead, they simply asserted that some DSS storage withdrawals were excluded from the restatement.

Q. Did Staff and Intervenor witnesses provide additional evidence in their rebuttal testimonies that would indicate that Nicor Gas' DSS restatements were deficient?

A. Mr. Zuraski provides no further evidence explaining how the company restatements with regard to DSS withdrawals were deficient. Mr. Mierzwa cites two Nicor Gas documents, NIC 114180 and NIC 109409, as support for his additional DSS withdrawal adjustments. (Mierzwa Reb., CUB Ex. 2.0, 14:325-15:336). According to Mr. Mierzwa, document NIC 114180 shows Nicor Gas' physical injections and withdrawals under its DSS storage for each year of the GCPP period, and document NIC 109409 shows the volumes reclassified as DSS storage withdrawals in Nicor Gas' restated financial results. (*Id*.) Finding discrepancies in the DSS storage withdrawals shown on these two documents, Mr. Mierzwa assumes that the withdrawals shown in NIC 114180 are the correct indicator of Nicor Gas' DSS storage withdrawals and calculates the differences between the withdrawals shown on this document and those shown on NIC 109409. He asserts that these differences represent "additional DSS withdrawals" by Nicor Gas and that his adjustment serves to "[adjust] Nicor's GCPP results to include all physical DSS withdrawal activity as is appropriate under the GCPP." (*Id*. at 15:333-34). He notes that this adjustment was not previously accounted for in the restatement.

More specifically, document NIC 114180 shows DSS withdrawals of 20.6 million MMBtu in 2001, while document NIC 109409 shows 2001 DSS withdrawals of 13.4 million MMBtu. According to Mr. Mierzwa, while Nicor Gas reclassified 13.4 million of DSS withdrawals in its restated financial results, it failed to consider the additional 7.2 million MMBtu (7.2=20.6-13.4). Mr. Mierzwa believes the 7.2 million MMBtu represents additional 2001 DSS storage withdrawals by Nicor Gas that should be included for purposes of calculating the SCA. (*Id*. at 14:325-15:346).

Q. What is your evaluation of Mr. Mierzwa's DSS withdrawal claim?

A. Mr. Mierzwa fails to explain why the differences in the figures shown on these two documents should be considered additional DSS withdrawals made by Nicor Gas. Clearly, Nicor Gas did not consider the differences he calculates as part of its DSS storage withdrawals, and Mr. Mierzwa does not explain why Nicor Gas' treatment of DSS storage withdrawals is incorrect. For purposes of restatement, Nicor Gas clearly believed that the figures shown in NIC 109409 (which I include as Nicor Gas Ex. 10.2) represented its actual physical DSS withdrawals. Nicor Gas' Aquifer Reports, provided in response to CUB 31.01 and CUB 28.05, show DSS withdrawals that confirm those shown on NIC 109409. These also correspond to the DSS withdrawals shown on NIC 114182 and NIC 114183. Nicor Gas Exhibit 10.3 contains excerpts of the Aquifer Reports and Nicor Gas Exhibit 10.4 contains NIC 114182-114183. Given this evidence, I do not believe Mr. Mierzwa has justified his claim that the differences he identifies should be used to adjust Nicor Gas' restated results. The restatement was ratified by Nicor Gas' outside independent auditors and was approved by the Securities and Exchange Commission. In light of all of this, I believe the Commission should reject

Mr. Mierzwa's and Mr. Zuraski's damage claims related to additional DSS storage withdrawals as being unsubstantiated.

VI. SALE OF GAS TO NICOR GAS' AFFILIATE AND WEATHER INSURANCE

Q. Will you summarize the issue regarding Nicor Gas' sale of gas to its affiliate?

A. Yes. Mr. Mierzwa and Mr. Zuraski both calculate damages associated with Nicor Gas' January 28, 2000 forward sale of gas to its affiliate Nicor Enerchange (for delivery in September and October 2000), alleging that the sale was made at a price that was too low (*i.e.*, below the market price of gas). (Mierzwa Reb., CUB Ex. 2.0, 17:380-91; CUB Ex. 1.24; Zuraski Dir., Staff Ex. 1.0R, 44:890). In my rebuttal testimony, I questioned their findings because it appeared they did not use forward basis differentials in deriving the forward gas prices for September and October 2000 that prevailed on January 28, 2000. (Carpenter Reb., Nicor Gas Ex. 5.0, 36:698-39:760). I also explained that any damages resulting from this transaction should be limited to any improper discount that was provided at the time of the sale (as opposed to the damages sought by Mr. Mierzwa and Mr. Zuraski, which reflect the higher spot prices that existed, in hindsight, at the time of delivery). (*Id*. at 39:763-40:779).

Q. How did Mr. Mierzwa and Mr. Zuraski respond to your rebuttal testimony about forward basis differentials?

A. Mr. Zuraski has responded by indicating that the basis differential he used was in fact a forward basis differential, and he includes references to Nicor Gas documents that show certain basis swap transactions that Nicor Gas entered into on December 29, 1999 and February 20, 2000. (Zuraski Reb., Staff Ex. 5.0, 15:279-87). Mr. Mierzwa states that the forward sales "transactions were improper and Nicor Gas should never have engaged in them." (Mierzwa Reb., CUB Ex. 2.0, 19:426-27). He therefore finds that:

> . . . it is appropriate for Nicor to bear full responsibility for the adverse impacts of the transactions as I am proposing. Failing to hold Nicor responsible for the entire adverse impact would place Nicor in the same position as if it had properly structured the original transactions. As I explained in my direct testimony, placing Nicor in the same position as though it had engaged in legitimate activities all along would set a bad regulatory precedent and essentially give utilities a green light to engage in improper behavior.

(*Id*. at 19:427-33).

Q. How do you respond to Mr. Zuraski and Mr. Mierzwa on this issue?

A. I disagree with Mr. Mierzwa's position that the transactions were inherently improper. As I explained in my rebuttal testimony, neither Mr. Mierzwa nor Mr. Zuraski has offered evidence that forward sales were not permitted under the terms of the GCPP. (Carpenter Reb., Nicor Gas Ex. 5.0, 39:764-65). They only argue that the price was too low. Moreover, while Mr. Mierzwa says Nicor Gas should have hedged the price of gas sold under these transactions in order to protect against the possibility of an increase in gas prices, the value of such hedges is only now known in hindsight, and Nicor Gas was under no obligation to do so under the terms of the GCPP. (Mierzwa Reb., CUB Ex. 2.0, 19:433-34). Thus, I continue to hold the opinion that if the Commission is going to award damages for these transactions, the damages should be limited to the degree to which it believes the transactions were below market (and should not be based on realized spot prices now known in hindsight, as proposed by Mr. Zuraski and Mr. Mierzwa).

Assuming the $0.04/MMBtu forward basis differential provided by Mr. Zuraski is correct, these transactions included a discount ranging from $0.10 to $0.15/MMBtu. If the Commission were to award damages for this claim, those damages should be no more than $226,650 (as shown in Figure 6 below).

Figure 6
Recalculation of Damages Due to Assumed Discounts
(Using Mr. Zuraski's Assumed Forward Basis to Chicago)

		July	**September**	**October**	**Total**
[1]		[2]	[3]	[4]	[5]
Henry Hub Futures Price (1/28/00) ($/MMBtu)	[a]	2.516	2.541	2.560	
Mr. Zuraski's Assumed Forward Basis ($/MMBtu)	[b]	0.04	0.04	0.04	
Mr. Zuraski's Assumed Forward Price in Chicago ($/MMBtu)	[c]	2.556	2.581	2.600	
Sales Price ($/MMBtu)	[d]	2.45	2.45	2.45	
Discount ($/MMBtu)	[e]	0.106	0.131	0.150	
Sales Volume (MMBtu)	[f]	300,000	1,500,000	1,500,000	
Total Discount ($)	[g]	31,800	196,500	225,000	**453,300**
Rate Payer Share	[h]				50%
Adjusted Discount ($)	[i]				**226,650**

Sources and Notes:
[a]: Gas Daily January 31, 2000, NYMEX Futures at Henry Hub.
[b]: ICC Staff Exhibit 5.0, p. 15 line 285.
[c] = [a]+[b]
[d], [f]: ICC Staff Exhibit 1.0R, p.44, Table 7.
[e] = [c] - [d]
[g] = [e] * [f]

Q. Did Mr. Mierzwa and Mr. Zuraski offer a similar damage calculation related to Nicor Gas' purchase of weather insurance (using realized spot prices)?

A. Yes, which I believe is unreasonable since Mr. Mierzwa and Mr. Zuraski are trying to capture the additional loss that occurred as a result of hindsight market conditions (*i.e.*, market prices increasing following the forward sale transaction), rather than limiting their claim to the discount that was provided under the forward sales transactions. (Mierzwa

Reb., CUB Ex. 2.0, 19:438-22:488; Zuraski Reb., Staff Ex. 5.0, 17:319-19:364). Again, Nicor Gas was not prohibited from entering into forward sales transactions under the terms of the GCPP. Moreover, as I explained in my rebuttal testimony, if prices had fallen over this period, it is likely that the damage proposals would have been limited to the size of the discount (while allowing ratepayers to claim their share of the resulting gains). (Carpenter Reb., Nicor Gas Ex. 5.0, 42:821-23). In fact, Mr. Zuraski agrees that he would not have proposed a surcharge on ratepayers if prices had fallen, and that he would calculate his damages differently in those circumstances. (Zuraski Reb., Staff Ex. 5.0, 18:352-19:364). That type of asymmetrical treatment is not reasonable, but instead is simply punitive. I recommend that the Commission reject these proposals and instead limit the damage claims related to weather insurance to the size of the discount at the time of the forward sales transaction.

VII. HUB TRANSACTIONS

Q. What claims does Staff witness Zuraski make regarding certain hub service revenues in his rebuttal testimony?

A. Mr. Zuraski claims that the revenues derived from certain Hub transactions (referred to as "multi-cycle" loans, which have a term of either eleven or twelve months) were inappropriately treated as utility income rather than being credited against purchased gas costs in the PGA. (Zuraski Reb., Staff Ex. 5.0, 20:412-21:421). Thus, he proposes an aggregate gas cost reduction adjustment of $10.3 million for the period 1999-2002 (an adjustment of $1.9 million for 1999 and an aggregate of $8.4 million for the 2000-2002 period). This translates into a refund of $6.1 million to ratepayers ($6.1=1.9 + $8.4/2). (Staff Ex. 5.2).

Q. How does Mr. Zuraski justify this refund proposal?

A. Mr. Zuraski's claim appears to be based on an arbitrary distinction he makes between hub transactions that are "multi-cycle gas loans" and all other hub transactions. He appears to be troubled by the length of the multi-cycle gas loans (with terms of either eleven or twelve months) and the fact that they are paired with a long-term storage agreement. In essence, he is asking the Commission to treat these multi-cycle loans as off-system transactions (which are credited against PGA gas costs) rather than hub transactions (which are treated as utility income and not credited against PGA gas costs). According to Mr. Zuraski, these multi-cycle loans are "completely different" from the ones considered by the Commission in Docket No. 93-0320 (for which the Commission did not require a credit to PGA gas costs), but rather "clearly fit within the category of the off-system transactions . . . ." (Zuraski Reb., Staff Ex. 5.0, 21:418-21).

Q. How do you respond to Mr. Zuraski's proposal?

A. I fail to see how the multi-cycle loans are more akin to off-system transactions (as claimed by Mr. Zuraski) such that their revenues should be credited against the PGA. It is not at all clear that the multi-cycle loans are fundamentally different from shorter term loans such that they should no longer be considered hub transactions (with the ratemaking treatment that is afforded to hub transactions). That is, despite the longer term of the transactions and the associated storage agreement, it appears that Nicor Gas is still loaning gas to third-parties (rather than third parties purchasing the gas on their own and injecting it into their storage capacity) just as it does under a shorter term loan without a storage agreement. As such, I believe the Commission should reject Mr. Zuraski's proposal to credit these hub revenues against PGA gas costs.[2]

VIII. CONCLUSION

Q. Does this complete your surrebuttal testimony?

A. Yes.

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[2] I understand that Nicor Gas now credits all hub revenues against PGA gas costs in accordance with the Commission's decision following the Company's 2004 rate case. Nonetheless, I believe Mr. Zuraski's proposal in this proceeding to have Nicor Gas credit against PGA gas costs the revenues from the Hub transactions he identifies in Staff Ex. 5.2 (which occurred in the 1999-2002 period) is inappropriate given the Commission-approved accounting treatment for Hub transactions in place during the term of the GCPP.